

Q&A

What is the NZ ETS?

The New Zealand Emissions Trading Scheme (NZ ETS) is a key tool to meet our domestic and international climate change targets to reduce greenhouse gas emissions, including the 2050 target set by the Zero Carbon Act.

It puts a price on greenhouse gas emissions – one unit, the New Zealand unit (NZU), represents one metric tonne of carbon dioxide. The units are then traded between buyers and sellers in the NZ ETS market.

The buyers are businesses that are legally required to give the government emissions units for every tonne of emissions they emit. The sellers are eligible foresters, who are given units by the government for carbon dioxide absorbed by their trees. This results in foresters getting a financial reward for planting trees, while businesses face a price for their emissions.

Units enter the market through ‘free allocation’ as well. The government allocates units to businesses that are at risk of being competitively disadvantaged internationally because of the cost of emissions and the NZ ETS.

The government will also sell units directly to the NZ ETS through auctioning, which is expected to begin in March 2021.

The Climate Change Response (Emissions Trading Reform) Bill enables a cap on the number of units supplied to the market (excluding forestry units) .

Why are NZ ETS reforms going ahead during the Covid-19 recovery?

Climate change is a priority for this Government. We need to continue New Zealand’s transition to a low-emissions economy. The NZ ETS reforms will make sure New Zealand has a fair, transparent infrastructure in place to meet our domestic and international climate change targets.

The unit price is likely to drop because of a fall in demand as many businesses have reduced their production levels, and transport emissions have decreased as people have been based at home.

The reformed NZ ETS also has price safety valves, which aim to keep prices within reasonable bounds, and gives both emitting businesses and forestry owners more certainty about prices than was previously available.

The improvements to forestry in the Bill will also support the recovery of the economy by encouraging more tree planting, creating jobs and income for rural communities.

Delaying the reforms would be more costly for New Zealanders in the long-term, as there will be increased pressure to deliver emissions reductions more quickly in the future.

What are the NZ ETS settings announced today?

The government has released detailed NZ ETS settings needed for the reformed NZ ETS to work: a provisional emissions budget, a unit supply limit or cap, and price controls for 2021-2025. The settings will be set through regulation after the Bill is enacted.

The provisional emissions budget:

The provisional emissions budget has been set at 354 million tonnes of CO₂ equivalent greenhouse gases for the 2021-2025 period.

An emissions budget is the total volume of emissions New Zealand is allowed to emit over a period of time.

The government is setting a provisional budget as a starting point to allow auctioning to start in March 2021 and give businesses regulatory certainty, but in future the government will receive advice from the Climate Change Commission before setting an emissions budget.

The Commission is required to recommend the first three emission budgets for the periods of 2022-2025, 2026-2030 and 2031-2035.

Following on from this advice, the government is required to set the first emissions budget by 31 December 2021, which will supersede the provisional emissions budget.

Unit cap:

The emissions budget guides the limit or 'cap' on the number of units that will be supplied to the NZ ETS market (excluding forestry units). The cap is the remaining number of units left after emissions not covered by the NZ ETS are removed, including agriculture, some of the waste sector, some of the forestry sector and gases covered by the greenhouse gas levy.

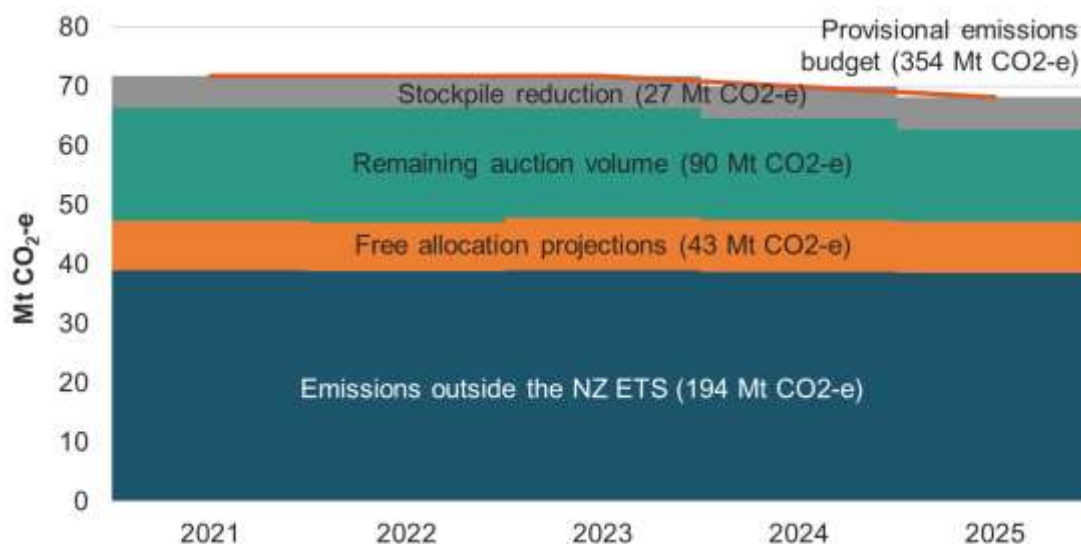
The provisional emissions budget is 354 Mt of CO₂-e for the 2021-2025 period, and the amount of emissions not covered by the NZ ETS is 194 Mt of CO₂-e. This results in a cap of 160 Mt of CO₂-e for the 2021-2025 period. As with the emissions budget, the cap will reduce over time, in line with New Zealand's 2050 target.

Annual cap on emissions in the NZ ETS

	2021	2022	2023	2024	2025	Total
Unit supply limit (millions of NZUs)	32.8	32.9	32.9	31.3	29.6	159.5

Out of the 160 Mt of CO₂-e units available, 27 Mt of CO₂-e will be withheld to reduce the volume of banked units, which are units already held in private accounts, and 43 Mt of CO₂-e units are expected to be freely allocated to some companies. This means 90 Mt of CO₂-e will be available for auctioning.

Auction volume remaining



Further breakdown: Limits of emissions (in millions of New Zealand emission units)

	2021	2022	2023	2024	2025	Total
Units to be auctioned	19.0	19.3	18.6	17.2	15.5	89.6
Units to be withheld from auctioning to reduce stockpile	5.4	5.4	5.4	5.4	5.4	27.0
Units released by other means	8.4	8.2	8.9	8.7	8.7	42.9
Approved overseas units	0	0	0	0	0	0
Combined volume limit	32.8	32.9	32.9	31.3	29.6	159.5

Auction price controls:

The government has set new price controls to act as safety valves when auctioning is introduced. There will be an auction floor price of \$20, which is the minimum price a unit is able to sell for at auction. A cost containment reserve will be triggered at a price of \$50, releasing more New Zealand units into the auction to ease demand.

The price controls limit the risk of prices falling outside of a range needed to meet an emissions budget, and prevents prices going too low or too high, which is particularly important given the economic impacts of the Covid-19 pandemic.

The minimum price gives foresters and new forest planters increased certainty that they'll get a minimum return for their investment.

The price control levels will rise by two percent, based on forecast annual inflation. If the price controls are used, it will also trigger a review of the price control and unit supply settings.

The price controls work as a backstop mechanism and do not represent a forecast of NZU prices.

Proposed NZU auction price control regulations



What is the fixed price option and why is it being extended?

The fixed price option (FPO) acts as the NZ ETS's de-facto price ceiling. Business required to hand over emissions units are able to buy them from the government at the fixed price, before immediately surrendering them.

The FPO was to be replaced by the cost containment reserve when auctioning started, but a Supplementary Order Paper (SOP) has been introduced to further amend the Emissions Trading Reform Bill.

The changes ensure that participants are able to use the FPO to cover all 2020 activities, regardless of when auctioning begins. This will give participants certainty about their compliance costs for the 2020 year, and support them during the transition to the reformed NZ ETS.

The FPO will also be raised from \$25 to \$35 – a mid-point between the proposed auction floor price of \$20 and the cost containment reserve of \$50. This is consistent with the proposal the government consulted on in December 2019.

The FPO is available to market participants as a fall back measure – NZ ETS participants can buy units for less than \$35 today.

What is free allocation and how will allocation recipients be affected?

The Government gives units to some businesses to recognise that the NZ ETS could impact their international competitiveness because of emission costs.

As previously announced, the reformed NZ ETS will slowly reduce the number of units provided by 1 per cent each year, starting from 2021 and continue until 2030, followed by a 2 per cent per year reduction from 2031 to 2040.

The consultation paper said 44 million units were to be freely allocated within 2021 and 2025, but that's changed to 43 million units because of Covid-19 forecast impacts.

The goal is to both incentivise businesses to reduce emissions, while allocating them enough free units, so they can remain competitive against international counterparts.

Why isn't New Zealand able to access international units?

Currently, no decisions have been made about whether or not New Zealand can access international markets. The international unit limit for the years 2021-2025 sits at zero, but it's required to be adjusted annually and could be updated in 2021.

Why are forestry policies being delayed?

The forestry policies in the Bill require regulations to be agreed to and established before they can take effect.

The COVID-19 pandemic has impacted Government's ability to develop and deliver forestry regulations by January 2022, given the regulations' complex and technical nature. As a result, the SOP defers implementation until January 2023.

To make sure new foresters who register under the current announced settings are not disadvantaged by the delay, forests registered in 2022 will also be able to choose whether to remain on stock change accounting or switch to averaging.

Stock change forests to be eligible for suspension of liabilities after an adverse event

The SOP suspends liabilities for carbon loss after an adverse event for forests using averaging accounting. If there was a major storm, for example, and trees were destroyed, foresters would otherwise have had to return units to the government as

the carbon stored in that forest had been lost. This provision in the Bill means these foresters will not be required to do so, as long as the forest is re-established.

The government has now extended this suspension to include foresters with existing post-1989 forests using stock change accounting. This was decided in response to feedback from consultation, and aims to reduce the inconsistent treatment of different forest types and provide more certainty for foresters in the scheme.

However, as policies aren't being introduced until 1 January 2023, foresters will still need to surrender units for any carbon lost in an adverse event until that time. The exemption scheme under new section 60A in the Bill could assist any participant significantly disadvantaged by an adverse event before the regulations are in place.

Part of the penalty regime to be delayed for small foresters

The NZ ETS is unique among international trading schemes as it has a large number of smaller participants, particularly in the forestry sector.

The new surrender/repayment penalty could cause serious hardship for small-scale forest owners, so in March 2020 Cabinet asked officials for a more flexible approach, but a long-term solution couldn't be resolved in the Bill's timeframe.

To mitigate the risk of hardship, the SOP delays the introduction of the new penalty for small forest participants, who meet the following criteria:

- The failure to surrender or repay units applies to forestry activities that occurred before 1 January 2023.
- Where an emissions return or notice results in a net liability less than 25,000 units per year covered in the return or notice.

Officials are to report back to Cabinet in mid-2021 about a long-term solution.

What are the forestry policies?

The Climate Change Response (Emissions Trading Reform) Bill makes substantial changes for forestry, including averaging accounting for post-1989 forests and other incentives to encourage forestry participation.

The regulations include:

- Introducing average accounting for post-1989 forests;
- Creating a new permanent forestry activity in the NZ ETS;
- Exempting eligible forests from the requirement to surrender units to cover emissions from temporary adverse events (such as fire or wind throw);
- Allowing some types of post-1989 forestry participants to offset their deforestation liability by planting a forest elsewhere; and
- Improving the pre-1990 forest land offsetting.

The current forestry accounting approach, also known as carbon stock change, requires a forester to hand back units to the government at every harvest cycle and then re-earn them as the replanted trees grow.

With average accounting, participants will no longer need to surrender units upon harvesting. They will instead receive units as their forest grows, up to a determined average level of long term carbon storage, and will not face any liabilities on harvest if they replant.

Why have the Climate Change Commission statutory deadlines been extended?

The Zero Carbon Act, passed in 2019, requires the Commission to provide recommendations for the first three emission budgets and advice by 1 February 2021. The deadlines were already tight, but this has been exacerbated by Covid-19.

The Government has agreed to extend the deadline for this advice by up to six months to 30 July 2021, saying it is necessary to provide robust, high-quality advice incorporating the impacts of Covid-19 and to meet its statutory responsibilities.

The SOP will give the Minister for Climate Change the ability to extend Commission deadlines under limited circumstances. Any request for an extension should be written, not exceed six months and be notified for transparency and greater certainty.

Will the prices and reformed NZ ETS be enough to reduce emissions?

The NZ ETS incentivises investment in low emission practices and technologies, but it is one tool of many required to drive necessary emissions reductions.

The Government has some policies in place and further policies in development that will also help reduce emissions.

Programmes already underway include decarbonising our transport sector, moving towards 100 per cent renewable electricity and reducing industrial emissions, supporting agriculture to improve its productivity and sustainability, and measures to encourage forestry.

What was the consultation process for the NZ ETS settings?

Public consultation on a provisional emissions budget and the NZ ETS settings was undertaken from 20 December 2019 to 28 February 2020.

The consultation received 133 written submissions, with the largest proportion of submitters being individuals, followed by business/industry groups, the electricity sector, NGOs and other sectors.

Submitters generally supported the idea of a provisional budget to help New Zealand meet its climate change targets, but opinions on the specific volume and proposed price control levels varied.

The consultation used online engagement and four public information sessions in Auckland, Wellington, Rotorua and Christchurch in February.

A series of 14 regional hui were held throughout New Zealand by the Ministry of Environment in February 2020 to discuss the ministry's work programme with Māori/iwi groups. The NZ ETS setting consultation was included on the agenda and was discussed with attendees.

Māori/iwi were invited to participate alongside other stakeholders, and notice of the consultation was also included in a regular Ministry iwi newsletter.

What are the next steps?

The Climate Change Response (Emissions Trading Reform) Bill still has to go through Third Reading before it becomes law. The NZ ETS settings released today will be set through regulation and need to be in place by the end of 2020 to make sure auctioning can start in 2021.

Decisions on NZ ETS settings will then be announced annually by the government and apply to the upcoming five years, through a 'coordinated decision making process'. In this process, the NZ ETS settings for the first two years are fixed unless there are special circumstances that require a change. NZ ETS settings for the three years following are set and announced, but can be adjusted.